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VISIONARY CRAIG MCCAW'S TOUGHEST TEST

HOW THE MAFIA MANIPULATES STOCKS

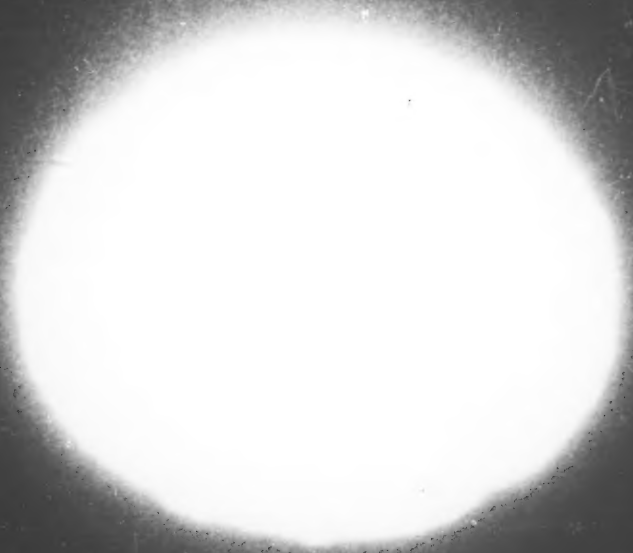
A GOLD-BACKED RUBLE?

DECEMBER 25, 1989

THREE DOLLARS SEVENTY-FIVE CENTS

Forbes

THE GLOBAL WARMING PANIC



A CLASSIC CASE OF OVERREACTION

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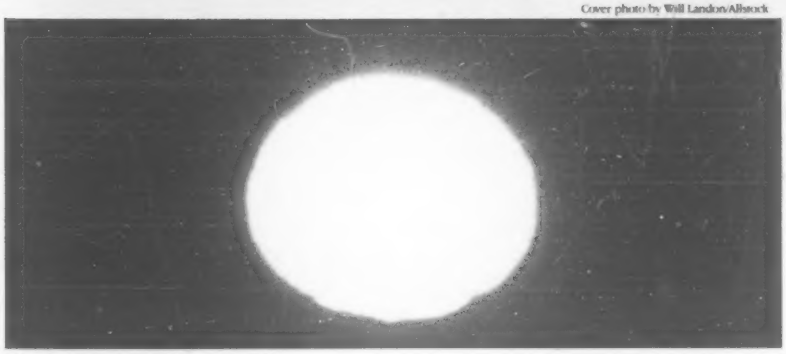

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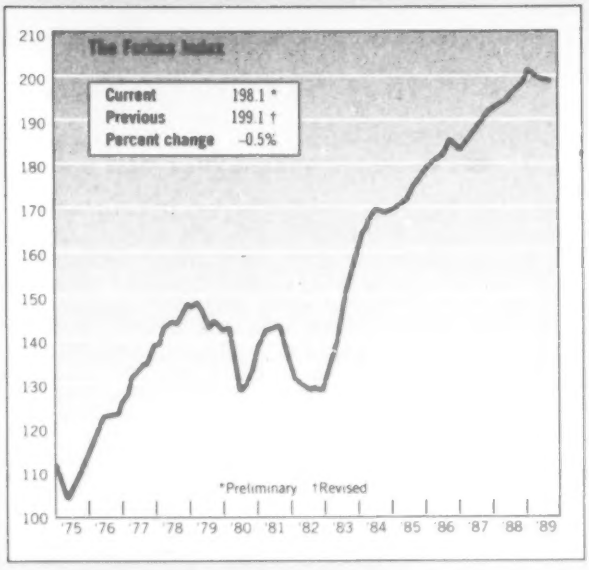
The Forbes Index



Too bad 1989 didn't end in September. The gross national product growth for the third quarter of 1989 was revised slightly upward, from 2.4% to 2.7% (annualized). Unfortunately, it looks like the economy got off to a bad start in the fourth quarter of 1989: The index of leading indicators lost 0.4% in October, and the Forbes Index slipped 0.5%, hitting its lowest point since November 1988.

The Consumer Price Index increased 0.5% in October and 4.5% during the latest 12-month period. Some good news: Personal income (wages and salaries) gained 1.2% in October, to an annualized $2.7 trillion, a record. Less happily, personal spending was off 0.2%, to $3.5 trillion.

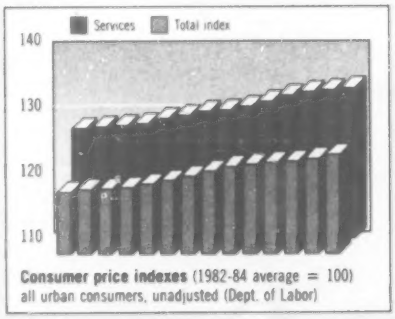
Other key rates	Source	Status
Prime rate	Chase Manhattan Bank	10.5%
Auto sales[1] year to date vs. 1988	Ward's Automotive	-4.0%
Index of leading indicators September vs. October	Dept. of Commerce	0.0%
Trade balance last 12 months	Dept. of Commerce	-$110 bil
Producer price index[2] October vs. 1988	Dept. of Labor	4.9%
GNP 3rd quarter vs. 2nd—annualized growth	Dept. of Commerce	2.7%

[1]U.S. based manufacturers only as of 11/20/89. [2]Finished goods.

Index Components

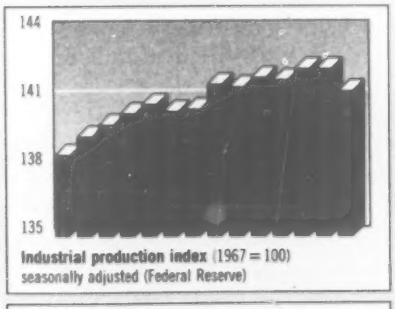
The Forbes Index is a measure of U.S. economic activity composed of 8 equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, new housing starts, total retail sales, the level of new orders for durable goods compared with manufacturers' inventories, personal income, total consumer installment credit.

To measure these 8 elements, FORBES monitors 10 series of U.S. government data. The last 14 months' data for each series are presented below.



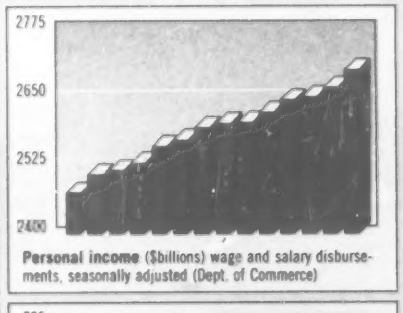
Consumer price indexes (1982-84 average = 100) all urban consumers, unadjusted (Dept. of Labor)

Manufacturers' new orders and inventories ($billions) seasonally adjusted (Dept. of Commerce)



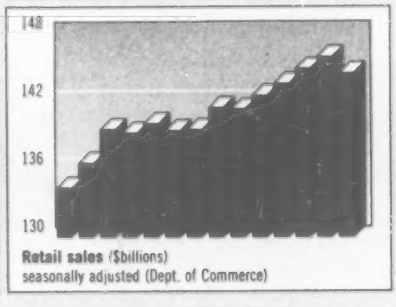
Industrial production index (1967 = 100) seasonally adjusted (Federal Reserve)

New housing starts (thousands) privately owned, unadjusted (Dept. of Commerce)

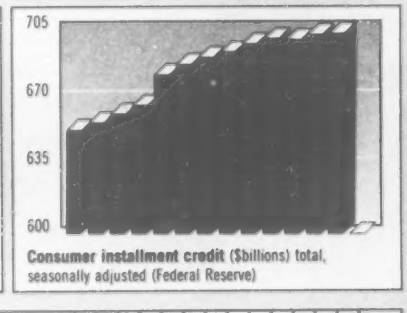


Personal income ($billions) wage and salary disbursements, seasonally adjusted (Dept. of Commerce)

New unemployment claims average for month (thousands) seasonally adjusted (Dept. of Labor)



Retail sales ($billions) seasonally adjusted (Dept. of Commerce)



Consumer installment credit ($billions) total, seasonally adjusted (Federal Reserve)

If you haven't already entered the lottery for a cellular telephone license, it's too late. But there are other ways to play the cellularization of rural America.

The great cellular giveaway

By Howard Rudnitsky

ROBERT FOISIE and his partners had a bountiful Thanksgiving this year. But their holiday came two weeks early, in a government-run lottery. In early November they won the rights to provide cellular telephone service in Hunterdon County, N.J. With a population of 99,000, the Hunterdon market is probably worth $20 million.

In the same lottery, conducted at the Federal Communications Commission in Washington, three Midland, Tex. investors won the cellular phone rights to Ocean County, N.J. The county has a population of 406,000. Estimated value of the cellular franchise: $70 million. The partners ponied up some $80,000 to play.

Two weeks later, TG Associates joined the winners' circle. The Portland, Me. group of 22 investors put together $55,000 in application, engineering and legal fees, entering more than 150 of the FCC's lotteries. Luckily, their number came up for Virginia's Amelia County, just outside Richmond. Potential customers: 82,000. Estimated value: $8 million.

These are but a few of the hundreds of investors who have won cellular rights to the nation's 428 rural markets. After 15 months of lotteries, the process is drawing to a close, having made many a millionaire and opened the prospect of cellular phone service for some 60 million additional people.

In the early 1980s the government began holding comparative hearings to decide what companies should get the rights to the nation's 90 largest cellular markets, the so-called Metropolitan Service Areas, or MSAs. Realizing that these hearings would take years to conclude for hundreds of smaller districts, the FCC decided to lottery off the cellular rights to the nation's 216 smaller urban markets—and the 428 rural markets.

Why did the government use a lottery to award the licenses? Why didn't it auction the licenses? That would have brought in billions for the rural licenses alone.

The lottery was chosen over an auction on the theory that the airwaves are public property and therefore can't be sold. Further, the FCC claims the law does not say it can auction off cellular licenses, but it does allow awarding them by lottery.

By using a lottery, however, the government in effect gave the proceeds it could have received to the lucky lottery winners, most of whom will eventually sell their licenses to bigger operators as the cellular industry continues to consolidate.

In any event, the winners in the rural service area, or RSA, lotteries are a diverse group. Consider the case of McCaw Cellular Communications, the nation's largest cellular company *(see related story, p. 80)*. When it came to the rural market, McCaw didn't enter the lotteries because it owned significant stakes in several cellular companies that were entering on their own. If McCaw had entered, it would have had more than one chance of winning in several individual markets, something the FCC won't allow.

But that didn't stop several McCaw employees from joining the party on their own. McCaw Vice Chairman Wayne Perry brought two junior McCaw executives into a partnership and negotiated $5 million in backing from one of McCaw's bank lenders. The trio entered lotteries for about 75 rural markets and in July came up a winner. Assuming final FCC approval, they will own the rights to Iberville, La., just south of Lafayette, valued at perhaps $18 million to $20 million.

"I never won a lottery before," says Perry good-naturedly. "I was astonished, since we entered relatively few. Many people have entered all 428 and haven't won yet."

Like Perry, many winners were sophisticated players. Oliver Grace Jr., an investor who is distantly related to the Peter Grace family, won the cellular rights to two rural areas. Thomas R. DiBenedetto, an investment bank-

Walter Calahan

A recent cellular license lottery in Washington
Now cellular millionaires, not the government, will cash in.

Another way to play

A less risky way to participate in the rural service area play is by investing in smaller telephone companies that have positive cash flow, and are selling at half their net asset values.

Telco cellulars	Service area population (millions) urban	rural*	Rural as % of total population	Latest 12-mo cash flow per share	Price/ cash flow	Net asset value per share	Recent price	52-week high	52-week low	Yield
Alltel Corp	3.7	2.6	41%	$6.00	6	$74	38½	41⅞	23⅛	3.3%
C-Tec	0.7	0.1	13	3.75	7	51	25	30	14	1.9
Centel Corp	14.4	0.8	5	7.25	9	101	64⅞	67½	29	2.0
Century Telephone	3.4	1.6	32	3.25	10	64	32⅞	35¼	17⅜	1.2
Contel Corp	16.7	4.7	22	6.50	5	82	34⅜	36¾	18⅜	3.2
Telephone & Data Systems	6.3	3.3	34	2.41	17	84	41½	46½	22½	0.6

*Estimated. *All data except for stock information provided by Moran & Associates, Inc.*

er and a shareholder in the Boston Red Sox, won the rights to Seminole, Okla., valued at some $35 million.

Once the FCC grants the lucky lottery winners final approval, the new licensees must have a system ready to operate within 18 months of acquiring a construction permit. Then, eighteen months after that, service must be available to 75% of the population in the district. But more and more people now expect that virtually all the 428 rural franchises will be up and running by mid-1992.

Little more than a year ago most industry analysts thought the nation's rural "pops," or potential customers, would fetch no more than $40 each. But today, rural cellular licenses are changing hands at prices that work out to about $85 a pop on average. That compares with $200 per pop in the more densely populated metropolitan service areas. But Martin Hyman of Booz, Allen & Hamilton predicts many of the rural licenses will rise in value. "In less than a year we'll see a number of rural service areas valued at over $200 a pop," he says. Three rural New Jersey service areas that were recently lotteried off "have better demographics than Philadelphia," which, Hyman notes, is losing population. Also, high family income, a characteristic of many exurban areas, tends to coincide with heavy cellular phone use. In rural Hunterdon, N.J., 34% of the families earn more than $50,000 a year, and in Sussex the percentage is 42%. In Philadelphia only 14% of families have annual incomes above $50,000. And all three Jersey RSAs have lucrative highway-roaming traffic.

Frederick Moran, president of Greenwich, Conn.-based Moran Asset Management, Inc., who has made a great deal of money investing in cellular companies such as Lin Broadcasting, argues that "well over 80% of all RSAs are contiguous to more densely populated MSAs. In most cases those RSAs will prove critical to the adjacent MSAs' success." According to Moran, combining a rural service area with a metropolitan one can double the cash flow of the MSA. It's a matter of fixed costs. Explains Moran: "The RSA will use the contiguous MSA's switching stations, its service, marketing and administrative personnel, its advertising coverage and management. Most costs are already in place."

In other words, the most obvious buyers of many of the newly awarded RSA licenses are going to be existing MSA operators who want to develop seamless regional systems, or perhaps superregional operators like Cellular Communications in Ohio, or even national systems like McCaw Cellular.

Cellular analyst Alfred Humphries, at Denver-based Hanifen Imhoff, Inc., takes issue with some Wall Street analysts who argue that capital costs per subscriber are higher in rural cellular markets than for metropolitan regions. Says he, "True, conventional telephone capital costs per pop are much higher in the rural service areas than in urban areas, but this makes cellular an inherently more cost-efficient technology than conventional telephones for much of rural and small-town America." Humphries' reasoning: Cellular avoids the greater costs associated with conventional telephone networks.

Not all rural service area franchises are gold mines. Indeed, many of the areas are sparsely populated and have no major highways. Numerous markets in west Texas, Wyoming, Montana, North Dakota and Nevada, for example, are lucky if they are worth $30 to $40 a pop. Says Hyman, "They may not find a willing buyer for many years."

Now poring over the rural markets are Anthony Easton and Quentin Breen, cofounders of San Francisco-based General Cellular Corp. Their goal is to build a company of rural markets, much the way McCaw has done with urban markets. Already General Cellular has privately raised some $20 million, with plans to acquire RSAs for stock in a tax-free exchange. So far the company has acquired five rural service areas from lottery winners at an average cost of $70 per pop. General Cellular intends to purchase at least a half-dozen more over the next six months and then go public.

Other companies being formed to buy up rural cellular franchises include Universal TeleCell and RSA Cellular. Meanwhile, Cellular Information Systems is combining existing MSAs in smaller markets with newly acquired RSAs and is in the process of issuing shares to the public.

Booz, Allen's Martin Hyman believes that stand-alone rural licensees will ultimately find it worthwhile to forge alliances with McCaw, which is eager to build a national cellular network, or other big operators, so as to achieve economies of scale. The smaller companies would have to pay royalties and fees, but they could benefit from the larger companies' reach and marketing strength.

Can investors who missed out on the lotteries get into the game? Some are trying to do so by snapping up shares in independent telephone companies that are acquiring rural service area territories *(see table)*. With traditional telephone businesses in place, these companies already have substantial positive cash flow compared with startup cellular companies. By acquiring cellular franchises and making them work, earnings and share prices seem sure to pop. ■

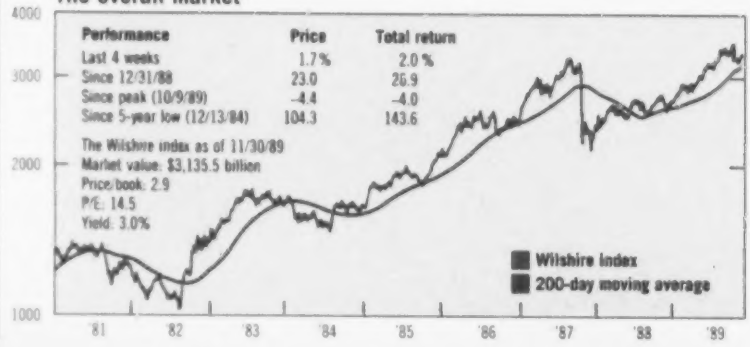
The Forbes Wall Street Review

Edited by Eric S. Hardy

Stephen Leeb is predicting an exciting stock market in 1990. Leeb, who edits the *Indicator Digest* market letter, thinks the Dow might go as high as 3500 next year. He is particularly bullish on the energy sector, including the oil drilling stocks. Leeb thinks lower interest rates will be the catalyst that drives energy and other stock prices higher.

Most market averages rose slightly in the last two weeks of November, but defense issues were weak, amid talk of lower defense budgets. Both Raytheon and General Dynamics show two-week losses of about 14%.

The overall market[1]



Closeup on the Market

Index or investment	Price	2-week change
Wilshire index 6,500 stocks, capitalization weighted	3,367.63	1.2%
Wilshire index 6,500 stocks, equal weighted	22.88	0.3
Dow Jones industrials 30 stocks, divisor-adjusted price average	2,706.27	2.7
S&P 500 Capitalization weighted cross-section, major stocks	345.99	1.6
NYSE Capitalization weighted, all listed common stocks	191.30	1.4
Amex Capitalization weighted total return stocks, warrants	373.84	0.4
Nasdaq Capitalization weighted, all issues except warrants	456.09	0.2
Amex international market index Capitalization weighted, 50 largest ADRs	325.17	3.8

Index or investment	Price or rate	2-week change
Europe, Australia, New Zealand and Far East[2] (EAFE) a dollar denominated capitalization weighted index	1011.50	4.6%
Institutional[3] Approximately 200 stocks with high institutional ownership	115.95	0.2
Individual[3] Approximately 200 stocks with low institutional ownership	106.43	-0.1
Technology Hambrecht & Quist index	256.73	2.2
Gold[4] (Composite quote of 6 major dealers)	$412.00	5.2
Yen[4] (per $U.S.)	142.85	-0.4
Commodity index[4] (CRB futures index, 1967 = 100)	228.55	-1.0
Oil[4] (W Texas intermediate)	$19.89	0.2
T Bills[4] (90 days)	7.58%	-8 basis points[5]
Broker loan rate[4]	9.50%	unchanged

The Best Performing Stocks

Company	Price	2-week change	P/E	Reason
Texas Instruments	36¼	21%	10	Japanese award patent for firm's computer chip
Visio	17½	21	NM	Significant earnings improvement expected for the fourth quarter
Mitchell Energy	19½	16	61	Early cold spell in the North will increase demand for natural gas
Home Shopping Network	6⅛	15	NM	Recent improvement in general business conditions
Lincoln Telecommunications	64	15	22	Jump in trading volume prompts takeover speculation

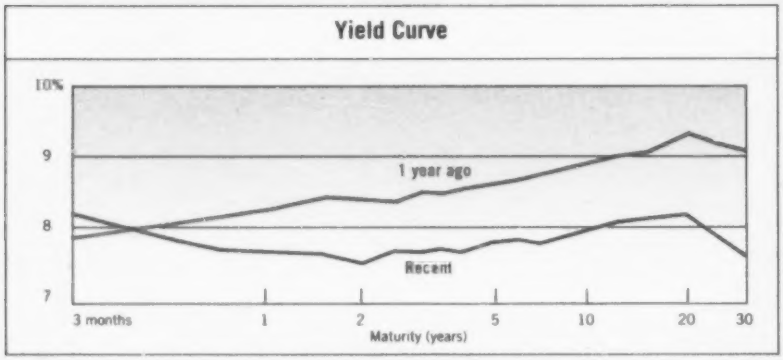
The Worst Performing Stocks

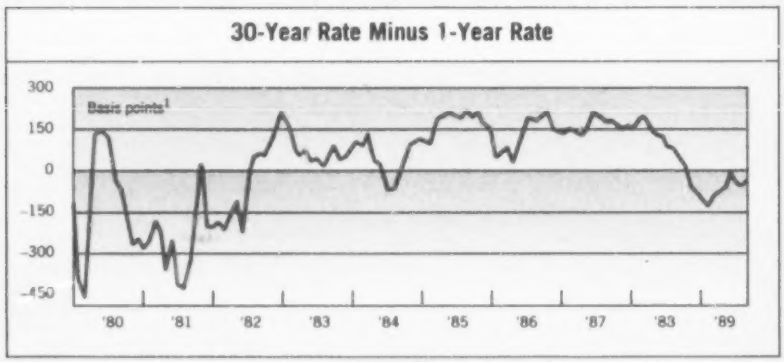
Company	Price	2-week change	P/E	Reason
Sotheby's	21¼	-25%	19	Investors speculate that boom in art prices may be slowing
Bank of New England	12¼	-17	5	Announces fourth quarter will show substantial loss
GIB Financial	19⅛	-16	7	Deteriorating loan portfolio prompts Moody's to downgrade preferred stock and commercial paper
LA Gear	36	-16	13	Lower earnings expected for fiscal 1989
Georgia Gulf	45¼	-16	6	May undergo recapitalization, which would reduce the likelihood of a takeover

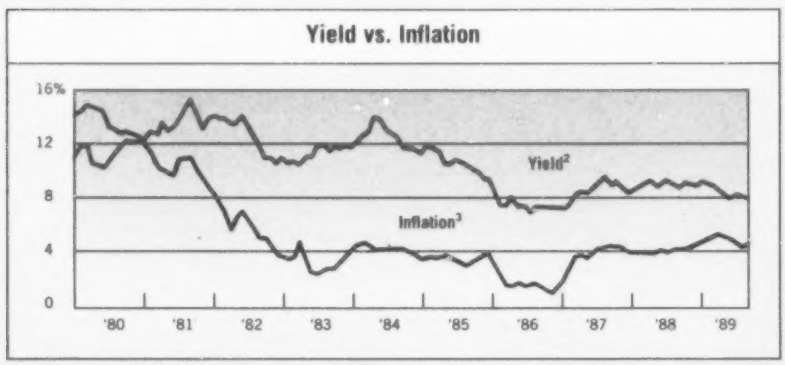
Note: All data for periods ending 11/30/89. Wilshire index reflects price performance. It differs slightly from market value of outstanding stocks because of retirements of equity since index was created. Stocks listed above have market capitalizations of $500 million or more. [1]Capitalization-weighted, prepared by Wilshire Associates, Santa Monica, Calif. [2]Morgan Stanley Capital International Perspective. [3]For period ending 12/1/89. A. Arbel, Cornell University, using Ford Database from Ford Investor Services. [4]Knight-Ridder Financial Information. [5]A basis point is equal to one-hundredth of a percentage point. NM: Not meaningful.

Fixed Income Review

Edited by Eric S. Hardy







Spread over Treasurys		Total returns		
Security	Basis points[1]	Security	1 year[6]	3 years[6]
AA corporates	73	AAA corporates	12.3%	29.5%
AAA industrials	64	Ginnie Maes[5]	11.5	32.0
Ginnie Maes	96	Junk corporates[4]	1.5	21.7
Junk corporates[4]	745	Municipals[5]	8.1	22.8
Municipals[5]	–43	Treasury bonds	12.2	25.1

Note: Except where footnoted, all information provided by Berkeley, Calif.-based Barra, a financial consulting firm. [1]A basis point is equal to one-hundredth of a percentage point. [2]Yield on ten-year Treasurys. [3]The trailing 12-month increase in the Consumer Price Index. [4]Source: First Boston. [5]Source: Shearson Lehman Hutton. [6]Through 10/31/89.

Two things make today's money market very unusual. One is that rates on municipal bonds are high relative to rates on taxable bonds. The other is that rates on long-term Treasurys are low relative to short-term rates.

Consider the muni-versus-taxable spread first. The yield on long-term municipal bonds is now within half a percentage point of the yield on Treasurys (see the –43 basis point figure at lower left, a basis point being a hundredth of a percentage point).

Figure in taxes in the top bracket (33%) and the return on a muni is much better than that on a Treasury. Indeed, as our bond columnist Ben Weberman points out on page 163, some mortgage-backed munis of very good credit quality have yields as good as those of Treasury notes.

Of course, buyers of bonds at today's prices could get hurt, since a general rise in interest rates will depress prices. But it's hard to see how *relative* yields on munis will get much higher. So, if you are bullish on bonds and are deciding between tax-frees and Treasurys, the facts seem to weigh heavily toward the tax-frees.

Now look at the relationship of short-term bond yields to long-term yields, captured graphically at left by Barra, a Berkeley, Calif. consulting firm. A year ago long-term bond buyers got better yields than did short-term buyers—in other words, the yield curve sloped upward *(see top chart)*. Now, though, the long-bond buyer gets no added yield. The historical picture shows that today's yield relationships haven't been seen much in the last eight years *(middle chart)*.

So the evidence does not weigh in favor of long Treasurys. Neal M. Soss, First Boston's chief economist, says a sluggish economy will work to push down short-term interest rates, but long-bond buyers won't see much benefit from this trend. Why? He predicts a simultaneous shift to a more normal upward-sloping yield curve sometime next year; this would tend to favor shorter-dated bonds relative to longer-dated ones. In short, if you take a chance on long Treasurys now, you may not get much of a price gain in the near term.